

## Performance as at 31st December 2021

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a. <sup>3</sup>
Fund <sup>1</sup>	3.0%	11.0%	46.2%	27.3%	17.3%	17.9%
Benchmark <sup>2</sup>	1.4%	2.0%	16.9%	15.7%	11.2%	11.0%
Difference	1.6%	8.9%	29.3%	11.6%	6.1%	6.9%
Microcap Index <sup>a</sup>	4.3%	8.3%	43.8%	33.7%	17.6%	17.4%

<sup>1</sup> Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes.

<sup>2</sup> Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

<sup>3</sup> Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

<sup>a</sup> Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.



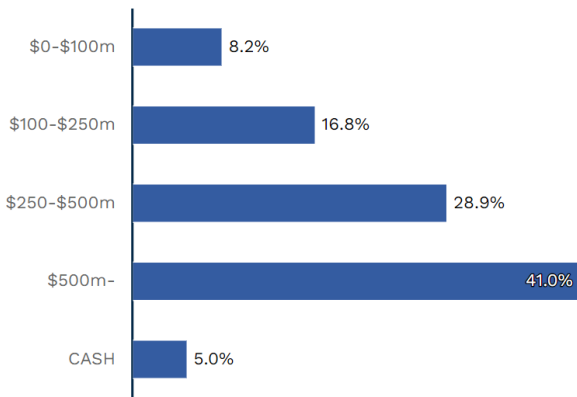
### Overall Commentary

The Spheria Australian Microcap Fund returned 3.0% (after fees) in the month of December, outperforming the Small Ordinaries Accumulation Index by 1.6%.

### Top 5 Holdings

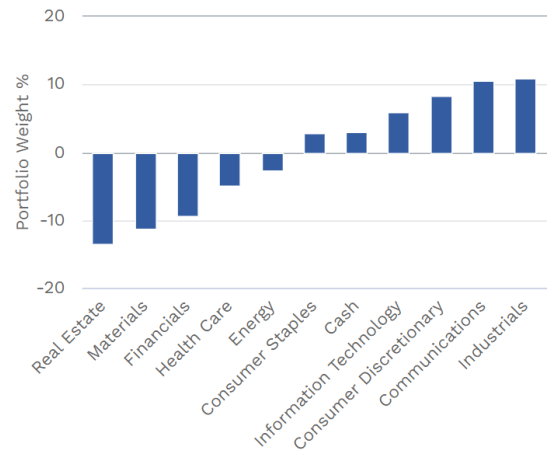
Company Name	% Portfolio
Class Limited	5.6
Michael Hill International Limited	5.4
Nzme Limited	5.4
Supply Network Limited	5.0
Vista Group International Limited	4.8
<b>Top 5</b>	<b>26.2</b>

### Market Cap Bands



Source: Spheria Asset Management

### Active Sector Exposure



Source: Spheria Asset Management

## Markets

The local small and midcap indices were both higher over December despite a significant pull back in the small cap tech sector driven by concerns about rising interest rates and the resulting implications for valuations. Resource stocks outperformed industrials over the month as commodities were largely higher across the board with lithium, iron ore and oil in particular being standouts. Despite the concerns about rising interest rates gold rose 3% over the month and gold equities performed reasonably well. Property names also outperformed despite concerns about rising yields for Government debt, perhaps showing that investors believe they could be effective hedges against rising inflationary expectations. The losers during the month were dominated by expensive technology stocks, particularly those that have yet to demonstrate sustained profitability with Imugene (IMU.ASX), Sezzle (SZL.ASX), Dubber Corp (DUB.ASX), Novonix (NVX.ASX), Australian Strategic Materials (ASM.ASX), Life360 (360.ASX), Mesoblast (MSB.ASX), Zip Co (Z1P.ASX) and PPK Group (PPK.ASX) all down > 15% over the month as the market became concerned about the impact of rising discount rates on their long dated (potential) cashflows. Surprisingly perhaps given the local newsflow, most re-opening trades were fairly flat for the month after falling over the back part of November on the emergence of the Omicron strain.

M&A activity was once again elevated during the month with BGH bidding for IVF provider Virtus Group (VRT.ASX) and IGO Group (IGO.ASX) finally making a cash offer for nickel miner Western Areas (WSA.ASX) after stalking it for some time. Meanwhile Humm Group (HUM.ASX) announced it had received proposals to acquire all or parts of its business and lithium developer Prospect Resources (PSC.ASX) announced the divestiture of its flagship Arcadia hard rock lithium project in Zimbabwe to lithium-ion battery producer Zhejiang Huayou Cobalt Co. Finally, Helloworld (HLO.ASX) sold its interest in its Australia and NZ focused corporate travel business to specialist global player Corporate Travel Management (CTD.ASX) for a combination of cash and scrip.

The Fund outperformed as the drag from its overweight to workforce productivity software supplier Nitro (NTO.ASX) and apparel retailer Universal Group (UNI.ASX) was more than outweighed by strong performances from low multiple consumer names like HT&E (HT1.ASX) and Michael Hill (MHJ.ASX).

## Major Contributors for the Month

**HT&E (HT1.ASX)** was the largest contributor as the stock rose 18% during the month. HT&E completed the previously mooted liquidation of part of its holding in online travel provider Luxe Group (owner of the Luxury Escapes brand) demonstrating the value in some of its smaller and less well understood assets. We still see significant valuation upside in the stock on a sum of the parts basis. In our view the market is either ascribing a much lower than average through the cycle multiple to the core audio franchise or assuming a level of permanent earnings impairment that is at odds with evidence from international audio markets.

**Michael Hill International (MHJ.ASX)** contributed as the stock returned 15% over the month. The retailer of fine jewellery in Australia, New Zealand and Canada provided a strong earnings update just prior to the end of the month flagging an EBIT result "well above" that achieved last year (excluding the one off jobkeeper subsidy) despite a significant impact from the delta lockdown over July through October in its key NSW and Victorian markets. While the Omicron outbreak and people reducing exposure on a voluntary basis may impact second half trading, we are hopeful there should be less disruption over the key Valentines and Mother's Day trading periods and would note that the business is cycling a very harsh lockdown of its Canadian operations over much of the 2H21 period. While there is some noise in the data, it is clear management of Michael Hill have presided over an extremely impressive turnaround of performance since the MD joined the business at the end of 2018 that is only now starting to be somewhat appreciated by the market. We see the firm as well placed to leverage its strong existing market position, robust profitability and cashflows and strongly net cash positive balance sheet to pursue growth opportunities not discounted by the current share price.

**Mader Group (MAD.ASX)** contributed after returning another 19% over the month. The founder-led outsourced plant maintenance provider has exceptional return metrics (ROIC was 36% in FY21), has established a strong beach head with a long runway for growth in the United States and has shown the ability to continue to grow strongly in Western Australia despite the already well-established market position there.

## Major Detractors for the Month

**Nitro (NTO.ASX)** was the largest detractor as it retraced 30% in sympathy with other technology stocks yet to demonstrate profitability. We are generally more sceptical than the average smaller company investor when it comes to extrapolating revenue growth trajectories into sustained positive cashflow but we like Nitro's demonstrated ability to win and onboard Fortune 500 level corporates with its core document productivity solution (competing head-to-head with the US\$252bn market cap company Adobe). We also see it as well placed to cross sell its newly acquired higher security level e-signing technology (Connective) into its document productivity customer base and vice versa. With a solid net cash position of cA\$60m and a modest cash burn we believe the high incremental gross margin and rapid revenue growth of the business makes it very likely that NTO.ASX can achieve sustained robust profitability and cashflows. At c4.5x forecast 1 year forward revenue, we believe NTO.ASX screens well relative to other global, scalable software providers.

**Universal (UNI.ASX)** detracted as the stock fell 11% over December. We felt the November trading update Universal provided was very solid in the circumstances with the business reporting some impact from the delta lock down mandated store closures but continuing to generate terrific profitability. While Omicron may have some impact on trading in the second half (more likely around staff availability given the customer cohort tends to be at low risk of serious illness) we think the stock screens well at c13x FY23 forecast PE for the growth prospects still ahead of it from store rollout, comp growth and online sales.

**Vita Group (VTG.ASX)** detracted after retracing 11% over the month. We suspect the business was hurt by investor concern about the likely impact of the Omicron variant on its remaining skin, health and wellness business Artisan. While we acknowledge this will no doubt affect consumer demand and potentially staff availability in the short term, we think the market is overly discounting the risk to the business given the strongly net cash balance sheet (expected to be c\$35m after the payment of a distribution of 3-6c in the 2H22). With a business doing c\$30m in annualised revenue (when peers trade at 2-3x revenue), a strongly net cash balance sheet, highly experienced board and management and an estimated remaining franking credit balance of c\$45m after the secondary distribution Vita appears priced for an extremely poor outcome given its current market capitalisation of only \$59m.

## Outlook & Strategy

We see the market as fairly precariously balanced with COVID-19 induced supply shortages and the pandemic induced shift of global purchasing power to goods leading to rising inflationary cost pressures. These are likely to impact margins for business models without real pricing power on the one hand and heap pressure on Central Banks to raise interest rates (at least nominal rates) on the other with negative resultant implications for the valuations of cash burning concept stocks with long dated (and by definition highly uncertain) future cashflows. The rampant spread of the Omicron variant adds to this uncertainty given its potential for reduced consumer expenditure in face-to-face channels and logistical bottlenecks in supply chains as workers convalesce upon a positive diagnosis or isolate upon exposure to confirmed positive cases. Nevertheless, the experience of South Africa shows there is light at the end of the Omicron tunnel with cases, hospitalisations and even deaths all now well down from their peak in the first impacted province of Gauteng (home to the Capitol Pretoria and the major commercial hub Johannesburg). We remain confident that services will eventually trend back towards their historical share of consumption and GDP. We therefore remain constructive towards businesses with a track record of profitability and cash conversion (alongside a solid balance sheet) even where they have been hurt by the pandemic. On the flip side, we continue to avoid capitalising profits of companies that have been boosted above a sustainable baseline by COVID-19 induced behaviours.

We would expect a significant number of short-term earnings downgrades from Omicron and hope to selectively take advantage of these where the market is capitalising a more negative long-term outlook than we feel is reasonable. We continue to be positioned in stocks with significant valuation support, proven business models and good balance sheets as we expect M&A activity to remain robust given the procyclical nature of boards, corporate balance sheets being well cashed up and equity and debt capital remaining cheap and readily available. There continues to be pockets of the market (those leveraged to popular thematic) that appear well and truly overvalued. We continue to avoid these given a market that is inherently inefficient and regularly presents us with opportunities for rotation into names that satisfy our requirements on cashflow, balance sheet strength and valuation.

## Platform Availability List

If a fund is not available on your preferred platform, please contact us. Please check with your platform for minimum investment requirements and fees.

<a href="#">Aegis</a>	<a href="#">FNZ Group</a>	<a href="#">MLC Navigator</a>	<a href="#">Praemium</a>
<a href="#">Asgard</a>	<a href="#">HUB24</a>	<a href="#">MLC Wrap</a>	<a href="#">Premium Choice</a>
<a href="#">BT Panorama</a>	<a href="#">IOOF Portfolio Service</a>	<a href="#">Netwealth</a>	<a href="#">Wealth02 uXchange</a>
<a href="#">BT Wrap</a>	<a href="#">IOOF Pursuit</a>	<a href="#">OneVue</a>	
<a href="#">DPM</a>	<a href="#">Macquarie Wrap</a>	<a href="#">PowerWrap</a>	

Spheria Australian Microcap Fund	
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Investment Objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 250 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Holdings	Generally 20-65 stocks
Distributions	Annually
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee
Cash	Up to 20% cash, typically 5% - 10%
Expected Turnover	20% - 40%
Style	Long only
APIR	WHT0066AU
Minimum Initial Investment	\$25,000

## Fund Ratings



## Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email [distribution@pinnacleinvestment.com](mailto:distribution@pinnacleinvestment.com)

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